

**Department of Legislative Services**  
Maryland General Assembly  
2002 Session

**FISCAL NOTE**

Senate Bill 399           (Senator Stone)  
Budget and Taxation

Ways and Means

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**Income Tax - Subtraction Modification for Retirement Income - Rollovers to  
Individual Retirement Accounts**

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This bill allows income from a rollover individual retirement account or annuity (IRA) under section 408 of the Internal Revenue Code (IRC) to be included within the subtraction modification allowed for retirement income from an employee retirement system if: (1) the contributions to the IRA consist entirely of the tax-free rollover of distributions from an employee retirement system; and (2) the tax-free rollover resulted from the mandatory withdrawal of amounts in the employee retirement system.

The bill takes effect July 1, 2002 and applies to all taxable years beginning after December 31, 2001.

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**Fiscal Summary**

**State Effect:** The extent of any general fund revenue loss depends on a number of unknown factors which include the number and amount distributed each year from such nontaxable rollovers and the amount of Social Security received by these individuals. Under one set of assumptions, general fund revenues could decline by approximately \$1.7 million annually.

**Local Effect:** Based on the assumptions above, local government revenues could decrease by approximately \$982,200.

**Small Business Effect:** None.

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## Analysis

**Current Law:** See below.

**Background:** Current Maryland income tax law includes tax relief for elderly individuals in several forms.

### *Social Security Benefits*

Social Security benefits and benefits received under the Railroad Retirement Act are totally exempt from the Maryland income tax, even though they may be partly taxable for federal income tax purposes.

### *Pension Exclusion*

Maryland law provides a special pension exclusion (in the form of a subtraction modification) for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified maximum amount of taxable pension income (\$17,300 for 2001) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payment received.

The current pension exclusion is that it is limited to income received from an “employee retirement system.” Chapter 524 of 2000 (SB 401) provides a definition of an “employee retirement system” to clarify the types of retirement income that may be included for purposes of calculating the pension exclusion.

Eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under sections 401(a), 403, or 457 of the IRC. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, Individual Retirement Arrangements (IRAs), Keogh plans, and simplified employee pension plans (SEPs) are not considered employee retirement systems.

The “Social Security offset” is the reduction in the maximum pension exclusion allowed under current law by the amount of Social Security benefits received by the individual. The Social Security offset was established at the same time as the pension exclusion. The offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of the allowable exclusion by the amount of any Social Security benefits received.

*Additional Personal Exemptions for Elderly Individuals*

In addition to the regular personal exemptions allowed for individuals (\$2,100 per exemption for 2001), each individual age 65 and older is allowed to deduct an additional \$1,000 personal exemption.

**State Fiscal Effect:** The table below presents the savings to a hypothetical retiree under current law and under the bill. The retiree is assumed to receive \$13,000 in annual pension income through an employer retirement plan, \$4,000 in distributions from an IRA, and \$0 in Social Security (SS) payments. As the table indicates, the additional State tax savings to the retiree as a result of the bill is \$190.

<b>State Tax Savings to Retirees from the Pension Exclusion in 2002</b>						
	<u>Current Law</u>			<u>SB 399</u>		
Types of Income	Retirement Income	IRA	SS Payment Received	Retirement Income	IRA	SS Payment Received
Amount of Income	\$13,000	\$4,000	\$0	\$13,000	\$4,000	\$0
<b>Pension Exclusion Calculation (assume max. SS benefit allowed in 2001 is \$17,800)</b>						
	Take lesser of:			Take lesser of:		
	\$13,000 or (\$17,800 - \$0)			\$17,000 or (\$17,800)		
Pension Exclusion	\$13,000			\$17,000		
State Tax Savings	\$618			\$808		

The actual cost of the bill, which cannot be reliably estimated at this time, depends on the number of rollovers and the amount distributed each year from rollovers that were formerly distributed from an employee retirement system resulting from the mandatory withdrawal of amounts in the employee retirement system and the amount of Social Security benefits received by these individuals.

However, *for illustrative purposes only*, based on the tax year 1997 and 1999 income tax return data, it is estimated that general fund revenues would decrease by about \$1.7 million in tax year 2002. Although the pension exclusion is expanded for tax year 2002, it is assumed that most taxpayers will not adjust their estimated payments to reflect the increased subtraction until after July 1, 2002. The estimate is based on the following facts and assumptions:

- For tax year 1999, approximately 14,957 returns were filed with an IRA distribution totaling \$281,383,862, but no pension income; the average distribution was \$18,814; the average pension exclusion in tax year 1997 was \$7,207.
- The maximum annual growth in the pension exclusion amount is 4%.
- 25% of IRA distributions resulted from the nontaxable rollover of a distribution from an employee retirement system that resulted from the mandatory withdrawal of amounts in the employee retirement system, and each taxpayer qualifies for an estimated average pension exclusion of \$8,768 in tax year 2002.
- Permanently disabled individuals and spouses who take the pension exclusion increase costs by approximately 7%.
- The maximum annual benefit under the Social Security Act for tax year 1996 was \$14,400 (\$17,300 for tax year 2001).

**Local Revenues:** Local revenues would decrease by approximately 2.8% of the total State subtraction taken in tax year 2002. Based on the estimate above, this would result in a loss of approximately \$982,200 in tax year 2002.

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### **Additional Information**

**Prior Introductions:** This bill was introduced as SB 152 in the 2001 session. No action was taken by the House Ways and Means Committee.

**Cross File:** None.

**Information Source(s):** Comptroller of the Treasury (Bureau of Revenue Estimates), Department of Legislative Services

**Fiscal Note History:** First Reader - February 10, 2002  
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